



STATE OF NEW JERSEY
Board of Public Utilities
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W. Terry Boston
President and Chief Executive Officer
PJM Interconnection, LLC
955 Jefferson Avenue
Norristown, Pennsylvania 19403

Re: Reliability Pricing Model
2012-2013 Base Residual Auction Results

Dear Mr. Boston:

On May 15, 2009, PJM announced the results of its latest Base Residual Auction under the Reliability Pricing Model (RPM). The auction concerned capacity needs for the period from June 1, 2012 through May 31, 2013. The New Jersey Board of Public Utilities (Board) and its staff have been working cooperatively with PJM in efforts to improve RPM. The results of this most recent auction, and information that PJM has provided in an effort to shed more light on those results, provide a foundation for a number of potential improvements outlined in this letter.

Specifically, three related developments illustrate challenges that continue to hamper the Board's efforts to ensure that New Jersey electricity customers receive reliable supplies of electricity at a reasonable price:

- Generation capacity in PS North suffered derates totaling more than 800 megawatts, a very large number considering that only about 3,520 megawatts of capacity cleared in the 2012-13 auction.
- PJM's modeling assumed that a new transmission line, designed to export 670 megawatts of capacity to New York City, would be in service by June 1, 2012, based on the execution of an interim Interconnection Services Agreement in August 2008 among Hudson Transmission Partners, LLC (the developer of the line), PJM, and PSE&G.
- For the first time, the 2012-13 auction established a significantly higher price for capacity in the PSE&G North Locational Deliverability Area (PS North) than in the rest of the Eastern Mid-Atlantic Area Council (EMAAC) region.

The Board's concerns and recommendations are outlined below.

1. Efforts to coordinate planning between PJM and the New York Independent System Operator (NYISO) continue to be unfruitful, and will remain so unless the Board and the New York State Public Service Commission are included in the effort.

We understand that PJM and the NYISO have held discussions in an attempt to better coordinate transmission planning between the two regions. Although Board staff was able to participate in some discussions in the context of the "ConEd Wheel" proceeding before the FERC, the inter-regional discussions to date have otherwise had little or no representation of the interests of New Jersey electricity customers.

The most recent auction results demonstrate what is at stake for New Jersey customers. Tangible progress on the Hudson Transmission Partners project (which would create an additional path for exporting power from PSE&G North to New York City) appears to have played a significant role in the higher capacity prices in PSE&G North. Those higher prices will be borne by all customers in the PSE&G zone, representing about 70 percent of the customers in the state.

It also appears that the Hudson Transmission Partners project will significantly increase the Capacity Emergency Transfer Objective - the emergency import capability required to satisfy established reliability criteria - in PSE&G North. In other words, projects crossing the New York-New Jersey border not only affect electricity prices here; they also can impair reliability. We understand that Hudson Transmission Partners cannot interconnect to PJM without also bearing the cost of certain upgrades to the transmission system in PJM to preserve reliability, but we also understand that upgrades paid for by PJM customers will reduce the extent and cost of that responsibility.

For these reasons, we believe that efforts to improve coordination between PJM and the NYISO will be well served by participation of the state commissions on either side of the Hudson River, especially if we can together engage the federal government in the effort. Currently, federal concern about interregional cooperation appears to be headed toward planning on a much larger, interconnection-wide scale. That is precisely the opposite of what is needed between New York and New Jersey. When interregional issues turn on a single transmission line only a few miles long, planning that involves more than half the country will not produce results.

It would be constructive for us to work together to make sure that the federal focus on interconnection-wide transmission planning does not lead Congress and the FERC to lose sight of much more pressing needs for interregional cooperation and planning.

2. Relevant and timely information from PJM, and an opportunity to discuss the information, is essential to the Board's efforts to ensure that New Jersey electric utilities provide safe, adequate, and proper service.

Both PJM and the Board have jurisdiction over efforts to preserve the reliability of the supply of electricity in New Jersey. PJM plans and operates the transmission system, and identifies transmission system additions and improvements needed to keep electricity flowing throughout the PJM footprint. The Board is responsible for ensuring that New Jersey electric utilities operate, maintain, and invest in the electric distribution system as needed to preserve reliability. In addition, the Board provides direct and indirect support for reliability through incentives and

regulatory requirements for clean local electric generation, energy efficiency, and demand response.

Relevant and timely information assists the Board in focusing these efforts. Conversely, the lack of such information hampers the Board's ability to act. For example, after PJM reported to the Maryland Public Service Commission of the likelihood of delay in completing major transmission projects, the Commission was able to respond by ordering the state's investor-owned utilities to develop Requests for Proposals to obtain additional demand response resources. The Board could have been in position to take similar action had it been aware of PJM's level of confidence that the Hudson Transmission Partners project would be in service by 2012. However, the Board did not learn that PJM had factored this project into its planning for 2012 until after the latest auction results were announced. Nor had the Board been advised that PJM and PSE&G had signed an interim interconnection services agreement with Hudson Transmission Partners in August 2008, although the Board recognizes that it would have been possible to ascertain this information through careful review of the section of PJM's website covering active merchant transmission queues.

Conversely, the Board also could have been helpful to PJM had there been more discussion of the Hudson Transmission Partners project. For example, the Board could have directed staff to investigate and learn of potential problems in obtaining the permits and approvals needed to build the line on the schedule that PJM had assumed.

We understand that additional projects capable of withdrawing capacity from PSE&G North and elsewhere in New Jersey may also be in PJM's transmission queue, and ask that PJM provide further information on any such projects.

3. A larger "holdback" beyond the 2.5 percent to be procured in the incremental auctions would improve states' ability to take actions that will preserve reliability.

Relevant and timely information from PJM is necessary but not sufficient to support the Board's efforts to ensure that New Jersey electric utilities provide safe, adequate, and proper service. The Board also needs an opportunity to act on that information.

The 2.5% "holdback" approved by the FERC in the recent RPM settlement (to which the Board did not object) offers some opportunity for action by the Board that can complement PJM's work to preserve reliability. However, that opportunity is too small to meet the magnitude of challenges to reliability such as those which arose in the 2012-2013 Base Residual Auction.

PJM's May 15, 2009 report on that auction advised that 814.8 megawatts of generation in PSE&G North had been derated and would be unavailable for 2012-2013. That quantity of derates was substantial; it represents nearly a quarter of the 3,520 megawatts that cleared in PSE&G North for 2012-2013. The Board did not learn of the derates until PJM released its report. We understand that PJM itself may have had no more than a few weeks of additional notice. A 2.5 percent holdback leaves far too little room to maneuver when 23 percent of the generation capacity in a locational deliverability area can disappear just before a Base Residual Auction.

New Jersey's Energy Master Plan seeks to support reliability by reducing peak demand; by improving energy efficiency to reduce energy consumption overall and during times of peak demand; and by maximizing the deployment of clean electric generation locally. To that end, New Jersey is providing low-interest financing and \$60 million in performance-based grants to

increase our combined heat and power capacity, working with utilities to facilitate financing of new solar electric generation capacity, and developing substantial incentives to bring 1,000 megawatts of offshore wind capacity into service by 2013. State and utility programs are also poised to invest more than \$500 million in energy efficiency through 2010. In addition, the Board continues to work with the electric distribution companies and curtailment service providers to increase demand response capacity.

These efforts can be implemented with significantly less lead time than the three years used in RPM. Conversely, when RPM seeks to procure 97.5 percent of our capacity needs in the Base Residual Auction, there is little opportunity to use the capacity market to support improved reliability through shorter lead time efforts on demand response, energy efficiency, and local distributed generation.

The 2.5 percent holdback in the Base Residual Auction, approved by the FERC in a decision on a recent RPM settlement which the Board did not oppose, was based more on what was needed to complete a settlement at the time and less on what would be the best approach to preserving reliability through complementary state and PJM efforts. The NJBPU asks that a re-evaluation of the holdback be commenced as soon as possible, with active involvement by state commissions. The goal of that involvement would be to maximize opportunities to preserve reliability with all of the tools that PJM and the states collectively have at their disposal.

4. The results of six auctions raise a legitimate question whether fundamental changes to RPM are needed in order to bring new generation capacity to the areas where it is needed most.

In its December 22, 2006 Order approving the original RPM settlement, the FERC stated:

The Settlement addresses the Commission's concerns that appropriate price signals are available to provide incentives to construct facilities necessary for regional reliability by assuring that the market value of resources used to meet the capacity requirements reflect actual deliverability and availability of the capacity resource within the specific region relying on that resource.¹

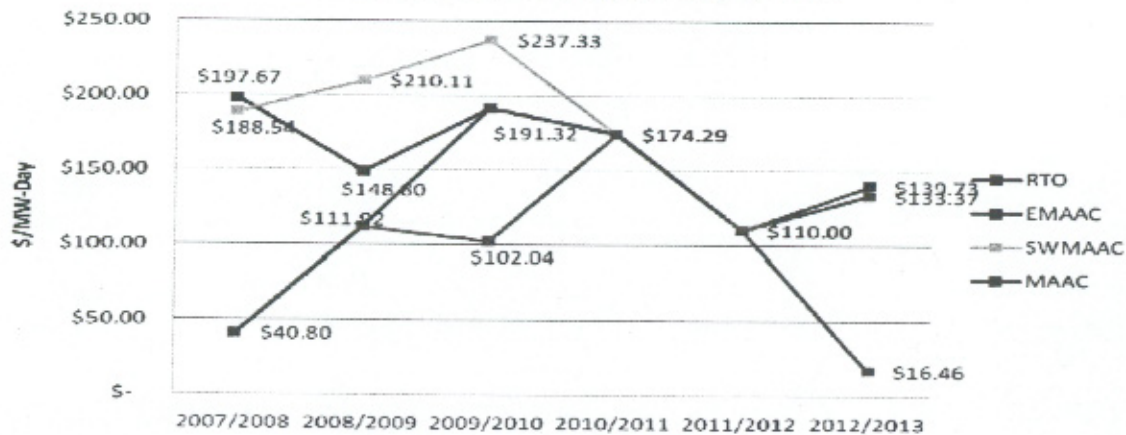
The FERC also noted PJM's concern that the previous capacity market provided "no price difference among resources in different locations to signal whether that capacity is more or less valuable due to its location."²

In the first six Base Residual Auctions, RPM has not sent "appropriate price signals" to "provide incentives to construct facilities necessary for regional reliability." On the contrary, the results of the first six auctions have varied too widely to provide a reasonable incentive. PJM's chart below illustrates the problem, which is even more apparent when the results for PSE&G North (\$185) and DPL South (\$222.30), which were omitted from the chart, are considered:

¹ Order Denying Rehearing And Approving Settlement Subject To Conditions (December 22, 2006), para. 68.

² Id., para. 14.

RPM Base Residual Auction Resource Clearing Prices (RCP)



The large variation in prices year-to-year are only part of the problem. There has also been a large variation in the difference between prices in the most constrained areas and the rest of the RTO. For 2011-2012, there was no difference in clearing price across the entire PJM footprint. For 2012-2013, the clearing price varied by more than an order of magnitude across the footprint, ranging from \$222.30 in DPL South to \$16.46 in most of the RTO.

Six auctions have not produced the results that PJM promised the FERC. The NJBPU would like to discuss with PJM what can be done to improve the situation materially. Please have your office contact NJBPU Chief Counsel Sam Wolfe to schedule time when we can meet.

DATED: 8/3/09

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